

# THE CORPORATE GOVERNANCE STATEMENT AND AUDIT COMMITTEE IN THE EUROPEAN UNION AND REPUBLIC OF SLOVENIA

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*Summary: As a rule, public companies in the Republic of Slovenia use a two-tire system of corporate governance. The supervisory board in such companies can establish a balance among the interests of managers, shareholders, stakeholders and social groups allowing the corporation to function effectively in the long-term. At the same time, the work of the audit committee, together with a clear but complex corporate governance statement, ensures better supervisory powers and provides support to shareholders in supervising the company.*

## 1. Introduction

In the area of corporate governance, the Republic of Slovenia has complied with amendments to the relevant directives<sup>1</sup> and implemented them in its corporate legislation acts. Slovenia thus amended its basic company law (hereinafter the Companies Act (ZGD-1)) by recently adopting two acts amending the Companies Act, namely ZGD-1B and ZGD-1C.<sup>2</sup>

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<sup>1</sup> This article is concerned in particular with the following EU Directives: Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (2006) OJ L224/1; Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (2006) OJ L157/87; Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (2007) OJ L184/17.

<sup>2</sup> The Act Amending the Companies Act (ZGD-1B) was published in the Official Gazette (OG) of the Republic of Slovenia no 68/2008 of 8 July 2008 and the Act Amending the Companies Act (ZGD-1C) in OG 42/2009 of 5 July 2009. This article takes into account both these amendments to the Companies Act (ZGD-1), OG 42/06 and 60/06, Corrigendum 26/07; the Act Amending the Workers' Participation in Management Act (ZSDU-B), OG 33/07; the Act Amending the Court Register Act (ZSReg-B), OG 67/07; and the Financial Instruments Market Act (ZFTI), OG 10/08). The abbreviation ZGD-NPB-1C denotes the unofficial consolidated version of the Companies Act, including the cited acts amending ZGD-1 (ZGD-1B and ZGD-1C).

In the EU, good corporate governance practices are applied through the recommendations of the European Commission. EU Member States may implement such recommendations in their national legislation.<sup>3</sup> Recommendations, however, are also implemented in codes as autonomous legal sources of corporate governance in EU Member States.<sup>4</sup> Among the recommendations that were taken into account in the drawing-up of the 2007 Slovenian Management Code for Publicly Traded Companies (hereinafter: the CG Code)<sup>5</sup> was the Recommendation on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board of 2005.<sup>6</sup>

The Republic of Slovenia has recently combined two techniques for creating and developing good corporate governance practices. New instruments for the execution of supervisory powers have been introduced by the CG Code. Simultaneously, companies are required by law to explain the use of the basic CG Code principle 'comply and explain'.

In the Republic of Slovenia, companies may choose a two-tier management system by appointing a management board and a supervisory board or a one-tier management system by appointing a board of directors.<sup>7</sup> As a rule, public companies use a two-tier system of corporate governance. The supervisory boards of public companies appoint audit committees and prepare corporate governance statements. This article analyses the importance of these instruments in the development of good corporate governance practice in the European Union and the Republic of Slovenia by examining the role and competence of the supervisory board.

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<sup>3</sup> See for example Commission (EC), 'Report on the application by the Member States of the EU of the Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board' (Staff Working Document) SEC (07) 1021, 13 July 2007.

<sup>4</sup> For more information on the topic, see for example EASD and ECGN, 'Comparative Study of Corporate Governance Codes Relevant to the European Union and Member States' (Final Report & Annexes I-III) (January 2002).

<sup>5</sup> The Management Code for Publicly Traded Companies was drawn up and adopted with the agreement between the Ljubljana Stock Exchange Inc, the Association of Supervisory Board Members and the Managers' Association of Slovenia of 18 March 2004 and subsequently amended first on 14 December 2005 and then again on 5 February 2007 <[http://www.zdruzenje-ns.si/db/doc/upl/kodeks\\_cg\\_2007\\_ang.pdf](http://www.zdruzenje-ns.si/db/doc/upl/kodeks_cg_2007_ang.pdf)> accessed 5 November 2009. See recent developments regarding the CG Code at <[http://seonet.ljse.si/default.aspx?doc\\_id=38872](http://seonet.ljse.si/default.aspx?doc_id=38872)> last accessed 5 November 2009.

<sup>6</sup> Recommendation 2005/162/EC of 15 February 2005 on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board [2005] OJ L 52/51 (hereinafter Commission Recommendation 2005/162/EC).

<sup>7</sup> Art 253 ZGD-NPB-1C. For more information on the similarities and differences between the two-tier and one-tier systems of corporate governance, see R Bohinc, *Korporacije (razlaga pravnih pravil in sodna praksa) (Corporations (Interpretation of Legal Rules and Case-Law))* (Ljubljana 2008) 443-457.

## **2. The supervisory board of joint-stock companies and corporate auditing in the EU and the Republic of Slovenia**

The execution of the supervisory function within a corporation is of key importance, particularly in areas where there is the possibility of a conflict of interest between different management bodies or when shareholders do not have the opportunity to participate directly in decision-making. Such circumstances particularly arise: a) upon the appointment of directors; b) in the remuneration of directors; c) in the auditing of corporations. For this reason, there should be a practice of establishing committees in these areas that are competent for appointments, remuneration and the auditing of the corporation.<sup>8</sup>

Audits of corporate data and operations are carried out by internal and external (statutory) auditors. Internal auditors carry out risk assessments for the needs of the management of joint-stock companies,<sup>9</sup> while external auditors make sure that the financial statements and data which managers provide to shareholders or which are made available to the public are true and complete.

Under Article 281 ZGD-NPB-1C, the supervisory board submits a proposal on appointing auditors to the general meeting of shareholders. This must be based on the proposal of the audit committee. The competences and tasks of the audit committee are defined in Article 280 ZGD-NPB-1C.<sup>10</sup>

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<sup>8</sup> Compare point 9 of the Preamble to Commission Recommendation 2005/162/EC and Article 279 ZGD-NPB-1C.

<sup>9</sup> The Internal Audit Section of the Slovenian Institute of Auditors argues that in the present-day business environment internal auditors constitute the key to successful business performance. Their work consists of auditing the processes, operations and goal-realisation of an organisation. They provide qualified counselling to the management at all organisational levels in its search for constant improvements. For more information on internal audits, see <[http://www.si-revizija.si/notranji\\_revizorji/index.php#Predstavitev](http://www.si-revizija.si/notranji_revizorji/index.php#Predstavitev)>.

<sup>10</sup> The tasks of the audit committee include:

- supervision of accounting reporting procedures;
- supervision of the efficiency of company internal control systems, internal revision, if it exists, and risk management systems;
- assessment of the composition of the annual report, including the drawing-up of the proposal for the supervisory board;
- ensuring the impartiality of the statutory auditor and other non-audit services;
- co-operating in determining the important segments to be audited;
- co-operating in the preparation of the contract between the statutory auditor and the corporation;
- co-operating with the statutory auditor in executing the audit of the annual report of the company, particularly concerning mutual information on important matters concerning the audit;
- other tasks defined by the articles of association or resolutions adopted by the supervisory board.

### **2.1. Audit committee**

Under ZGD-NPB-1C, the establishment of audit committees is mandatory for all public joint-stock companies, irrespective of the system of corporate governance.<sup>11</sup> In addition, their establishment is recommended by the CG Code for all joint-stock companies.

The audit committee as an expert body can, by virtue of its existence and composition, encourage a more objective evaluation of the risks incurred by a corporation and of their assessment. This evaluation is carried out by internal auditors. In addition, the audit committee ensures information is provided to shareholders and the public concerning the data contained in the relevant financial statements. Concrete co-operation between the audit committee, audit company and internal audit departments can constitute the very basis for the exercise of competent and correct auditing. A first-rate audit committee is able to substantiate its findings and concerns to the supervisory board and thus ensure that the supervisory board is informed of all relevant (including technical) facts and is thereby furnished with all the necessary data required for decision-making and carrying out its supervisory function.

The supervisory board is the body which is competent to carry out supervision and control over the operations of corporations, as provided for in the first, third and sixth paragraphs of Article 279 ZGD-NPB-1C.

### **2.2. Statement on corporate governance**

The Republic of Slovenia has also introduced the institute of corporate governance statement. A corporate governance statement is an additional instrument of control in the provision of information to shareholders, stakeholders and the public, particularly regarding issues posing risks from the point of view of conflicts of interest between the management bodies of public joint-stock companies.

Article 70 ZGD-NPB-1C provides that the business report of a company must set out a fair presentation of the development and results of the company's operations and its financial position, including the description of essential risks and uncertainties the company is exposed to.

In accordance with paragraph 5 of Article 70, companies whose securities are traded on the regulated market include a corporate governance statement as a special part of their business reports.<sup>12</sup> As a minimum, this quotes sections of the corporate governance code and includes

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<sup>11</sup> See Articles 279/1 and 289/3 ZGD-NPB-1C.

<sup>12</sup> A company may issue its corporate governance statement as a separate report together with the annual report of the company.

information on: a) the use of the corporate governance code; the way of using the rule of 'comply and explain' with regard to the particular code; and reasons for not applying particular parts of the code; b) the basic characteristics of the internal control and risk management systems in connection with accounting report system procedures etc. It also includes information on: a) significant direct and indirect ownership of the company's securities in the sense of achieving a qualified stake as stipulated by the act regulating acquisitions; b) each holder of securities carrying special control rights; c) all restrictions related to voting rights, in particular: restrictions of voting rights to a certain stake or number of votes; deadlines for exercising voting rights; agreements in which, on the basis of the company's co-operation, the financial rights arising from securities are separated from the rights arising from the ownership of such securities; d) the company's rules on the appointment or replacement of members of management or supervisory bodies, and changes to the articles of association; e) authorisations of members of the management, especially authorisations for issuing or purchasing own shares; f) the operation of the company general assembly and its major competences; g) the structure and operation of the management and supervisory bodies and their committees.<sup>13</sup>

Pursuant to Article 50a of the Act Amending the Companies Act (ZGD-1B), members of the supervisory board of a joint-stock company are obliged to ensure the drawing-up and publication of the corporate governance statement in compliance with the law. Members of the management and supervisory bodies of the company are obliged to jointly assure that the annual report with all its parts, together with the corporate governance statement, is drawn up and issued in accordance with ZGD-NPB-1C and Slovenian Accounting Standards or International Financial Reporting Standards. Annual accounts and their constituent parts must be signed by all the members of the management of the company.

### **3. The supervisory board's role in balancing corporate interests**

The supervisory board is a key and central body interposed between managers and shareholders which supervises the conduct of a company's business. At the same time, it ensures accurate and transparent information to shareholders on all the relevant facts required for their decision-making as well as information for corporate stakeholders and interested parties.

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<sup>13</sup> For more information on the topic, see D Djoki , 'Dodatna razkritja korporacijskih informacij po ZGD-1B' ('Additional Disclosures of Corporate Information under the Act Amending the Companies Act (ZGD-1B)') (2008) 8 Podjetje in delo 1637-1648.

The supervisory board is a body whose actions can introduce and enforce a balance between the interests of managers and those of corporation owners, subject to the efficient functioning of the corporation.

I consider the balancing of the interests of joint-stock companies as corporations to be the central issue of contemporary economics and society in general. Although the means of such balancing may be different, they all require responsible engagement by individuals and the credibility of the conduct and work of these individuals in the performance of their functions.

The supervisory board is a body which can fulfil the social responsibility of a corporation. It can serve either exclusively the shareholders or be a tool of the management. One can therefore conclude without any further digressions into corporate governance theories that in the contemporary world the role of the supervisory board is of extreme importance.

#### **4. Amendments to the Companies Act in ZGD-1C**

The Act Amending the Companies Act (ZGD-1C) connected the role of the supervisory board with the remuneration of its members. ZGD-1C devotes special attention to the remuneration of management bodies and to the remuneration-related tasks of supervisors. Supervisory board members cannot participate in profit-sharing. However, their remuneration can be framed by the general meeting of a company by fixing a company remuneration policy.<sup>14</sup>

The remuneration of Slovenian supervisory board members is determined in appropriate proportion to the tasks they perform and the financial situation of the company. As far as the remuneration of management bodies is concerned, one can expect in the future that this area will increasingly be subject to the decision-making of shareholders at general meetings.<sup>15</sup>

#### **5. Audit committees and corporate governance statements in the practice of the Republic of Slovenia**

Examination of the annual reports of the joint-stock companies entered on the first Ljubljana Stock Exchange listing of 2008<sup>16</sup> shows that

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<sup>14</sup> See Articles 284 and 294 ZGD-NPB-1C.

<sup>15</sup> Pursuant to the first paragraph of Article 37 of the Act Amending the Companies Act (ZGD-1C), companies are obliged to harmonise their articles of association with the provisions of the Act by 1 September 2010.

<sup>16</sup> <[http://seonet.ljse.si/?doc=PUBLIC\\_ANNOUNCEMENTS\\_BY\\_PRIME\\_MARKET\\_ISSUERS](http://seonet.ljse.si/?doc=PUBLIC_ANNOUNCEMENTS_BY_PRIME_MARKET_ISSUERS)> accessed 5 November 2009.

the public joint-stock companies entered on the listing have appointed audit committees. The 'comply or explain' principle relating to the Code on Corporate Governance has also been in operation in the companies entered on the standard listing.<sup>17</sup>

## 6. Conclusion

The Corporate Governance Statement under Article 70 ZGD-NPB-1C is not merely an administrative document which must accompany an annual report. Its content and the accurate disclosure of the data contained in it can constitute the basis for decision-making at the general meetings of joint-stock companies and for the auditing of a corporation.

When reviewing annual reports, the supervisory board can direct and dictate the disclosure of data and influence the transparency of corporate operations and decision-making by shareholders. The supervisory board plays a key role in supervising the drawing-up and publication of corporate strategic documents and annual reports on corporate operations and in the drawing-up of proposals for decision-making by the general meetings of joint-stock companies. By virtue of such a role and powers, the supervisory board also participates in the preparation of the statement on corporate governance and the remuneration policy of a company.

The role and importance of the supervisory board's (audit, remuneration, appointment) committees are increasing. One can see that the knowledge and orientations of members of committees are important for the execution of the supervisory board's functions. For this reason, greater attention should be devoted to their structure and functioning, as well as to their remuneration and the remuneration of supervisory board members.

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<sup>17</sup> <[http://seonet.ljse.si/?doc=PUBLIC\\_ANNOUNCEMENT\\_BY\\_STANDARD\\_MARKET\\_ISSUERS](http://seonet.ljse.si/?doc=PUBLIC_ANNOUNCEMENT_BY_STANDARD_MARKET_ISSUERS)> accessed 5 November 2009. In March 2009, the Ljubljana Stock Exchange Inc adopted Recommendations on Information to Listed Companies: The Ljubljana Stock Exchange Inc, Ljubljana, March 2009 <<http://www.ljse.si/cgi-bin/jve.cgi?doc=8261&sid=Z1oNERIUCtVa65RH>> accessed 9 November 2009. The CG Code is already being scrutinised in relation to the recent positions of the European Commission stated in Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (Text with EEA relevance) (2009/385/EC) OJ L 120/28 <[http://seonet.ljse.si/default.aspx?doc\\_id=38872](http://seonet.ljse.si/default.aspx?doc_id=38872)> accessed 9 November.